No. 11,795

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

ESTATE OF ISADORE ZELLERBACH, Deceased, J. David Zellerbach and Harold L. Zellerbach, Executors,

Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

APPELLANT'S OPENING BRIEF.

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APPELLANT'S OPENING BRIEF.

(a) STATEMENT OF JURISDICTION.

This is an appeal by a taxpayer from a decision of The Tax Court of the United States assessing deficiencies against appellant in income taxes for the years 1942 and 1943 in the respective amounts of $1,768.55 and $67,388.46, which decision was entered September 16, 1947. (Tr. p. 165.)

The opinion upon which said decision is based is reported in 9 Tax Court 89, and is likewise set forth at length on pages 136 to 165 of the Transcript of Record.

The Tax Court had jurisdiction of the controversy by reason of the fact that appellant's income tax re-

turns were filed with the Collector of Internal Revenue at San Francisco, and by further reason of the appellee's "Notice of Deficiency" dated September 20, 1945, addressed to appellant, a copy of which is attached as Exhibit "A" to appellant's petition filed with The Tax Court of the United States on December 12, 1945, and which appears at pages 10 to 17 of the Transcript of Record. The petition for a redetermination of the deficiency is set forth on pages 4 to 17 of the Transcript of Record.

A petition for a review by this Honorable Court of the decision of The Tax Court was filed with the Clerk of The Tax Court on October 14, 1947. (Tr. pp. 166 to 175.)

(b) STATEMENT OF THE CASE.

The controversy was submitted to The Tax Court for decision upon a written Stipulation of Facts (Tr. pp. 24 to 106) and the oral testimony of three witnesses.

The facts are stated in the Findings of Fact of The Tax Court. (Tr. pp. 137 to 145.) The following is a summary of the facts:

Isadore Zellerbach died testate on August 7, 1941, in the County of San Mateo, State of California, being at the time of his death a resident of the City and County of San Francisco, State of California; on the 2nd day of September, 1941 his will was admitted to probate by the Superior Court of the State of California, in and for the City and County of San Fran-

cisco, in those certain probate proceedings entitled "In the Matter of the Estate of Isadore Zellerbach, Deceased, No. 87,721", and J. David Zellerbach, Harold L. Zellerbach and Marcus M. Baruh, who were named therein as such, were appointed Executors, and Letters Testamentary were issued to them. Marcus M. Baruh died on the 6th day of April, 1942, and ever since said date J. David Zellerbach and Harold L. Zellerbach have been and now are the duly appointed, qualified and acting Executors of the last will and testament of Isadore Zellerbach, deceased. A copy of the said last will and testament of Isadore Zellerbach is attached to the stipulation of facts and marked Exhibit "A". (Tr. pp. 30 to 35.)

Under the decedent's last will and testament, there are certain specific legacies provided for after which the residue of the estate is directed to be distributed one-half to decedent's widow, Jennie B. Zellerbach, and one-sixth to each of the decedent's three children, to-wit, J. David Zellerbach, Harold L. Zellerbach and Claire Z. Saroni. (Exhibit "A", stipulation of facts, Tr. p. 34.)

On August 19, 1942, the executors of decedent's will filed with the Probate Court a petition praying for leave to distribute the specific legacies, which petition was granted on September 2, 1942. (Exhbits "E" and "F", stipulation of facts, Tr. pp. 55 to 66.)

On November 25, 1942, the executors filed with the Probate Court two petitions for partial distribution. In one the executors alleged that the income of the

estate (appellant herein) for the calendar year 1942 would approximate the sum of $317,000.00, and prayed for an order of the Probate Court authorizing them to distribute from the income of the estate the sum of $181,000.00 as follows: (a) to Jennie B. Zellerbach, the widow of the decedent, $22,000.00; (b) to J. David Zellerbach, the son of decedent, $53,000.00; (c) to Harold L. Zellerbach, the son of decedent, $53,000.00; (d) to Claire Z. Saroni, the daughter of decedent, $53,000.00. (Exhibit "G", stipulation of facts, Tr. pp. 62 to 65.)

This petition was heard on December 7, 1942 by the Probate Court, and was granted. (Exhibit "H", stipulation of facts, Tr. pp. 66 to 68.)

The other petition for partial distribution, which was filed on November 25, 1942, after alleging that all the gifts and legacies under the decedent's will were distributed on September 2, 1942 and paid, prayed for permission to distribute certain assets of the estate to the residuary legatees and devisees in the proportions that they took under the will, namely, one-half to the widow, and one-sixth to each of the children. (Exhibit "I", stipulation of facts, Tr. pp. 68 to 72.) This petition was heard by the Probate Court and granted on December 8, 1942, and the property described in the petition was ordered distributed in the proportions hereinabove set forth. (Exhibit "J", stipulation of facts, Tr. pp. 72 to 74.) The property so distributed on December 8, 1942 had a fair market value on that date of $1,146,000.00. (Paragraph 25, stipulation of facts, Tr. pp. 28.)

The income of the estate for the calendar year 1942, before any allowances for income distributed to the beneficiaries under the decedent's will (the residuary legatees and devisees) was $324,209.38, which said sum was composed of ordinary income in the amount of $316,595.74, and capital gains in the amount of $7,-613.64. (Paragraph 19, stipulation of facts; Tr. pp. 27 to 28.)

On December 31, 1942, the estate (appellant herein) had assets of $3,425,092.17 and liabilities of $1,419,-565.49, or an excess of assets over liabilities of $1,-934,526.68. This was after the distribution of $181,-000.00 in income and $1,146,000.00 in corpus, and after giving effect to all liabilities which were subsequently determined to be due. (Exhibit "S", stipulation of facts, Tr. pp. 99 to 103.)

The estate (appellant herein) filed income tax returns on a cash basis for the calendar year 1942 with the Collector of Internal Revenue at San Francisco, California, and claimed as a credit the amount distributed to the beneficiaries by the decree of partial distribution made by the Probate Court on December 7, 1942, and subsequently filed an amended return and claimed credit for the full amount of the income of the estate for the calendar year 1942, to-wit, the sum of $324,209.58. (Paragraph 2 and Exhibit "C", stipulation of facts, Tr. pp. 24 to 25 and pp. 37 to 48.)

The beneficiaries under the will reported in their respective income tax returns the full amount of the estate's (appellant herein) income for the year 1942; the widow, Jennie B. Zellerbach, having originally

reported only the amount of cash actually distributed to her, and subsequently having filed an amended return wherein she included as income distributed to her from the estate of the decedent, one-half of the income of the estate for the year 1942, to-wit, the sum of $157,661.87. (Paragraph 28, stipulation of facts, Tr. p. 29.)

On November 30, 1943, the executors filed a petition with the Probate Court for partial distribution, asking permission to distribute from the income of the estate for the year 1943 the sum of $96,000.00, which sum was to be distributed one-third to each of the children of the decedent, and no portion of the income was asked to be distributed to the widow, Jennie B. Zellerbach. The petition alleged that the income for the year 1943 would approximate the sum of $191,500.00. (Exhibit "Q", stipulation of facts, Tr. pp. 93 to 97.)

On December 13, 1943, the Probate Court made an order for partial distribution, authorizing the distribution of the amount of $96,000.00 as prayed for. (Exhibit "R", stipulation of facts, Tr. pp. 97 to 99.)

Jennie B. Zellerbach, the widow, reported in her income tax return for the year 1943 the fact that there had been distributed to her from the estate of decedent for the year 1943, the sum of $92,664.15. (Paragraph 29, stipulation of facts, Tr. p. 29.)

The total net income of the estate for the year 1943, before allowance for income distributed to beneficiaries during said year was the sum of $206,364.94,

which sum was composed of ordinary income in the amount of $188,328.30, and capital gains in the amount of $18,536.44. (Paragraph 20, stipulation of facts, Tr. p. 28.)

The estate filed its income tax return for the year 1943 on a cash basis with the Collector of Internal Revenue at San Francisco, California, and claimed as credit for income distributed to the beneficiaries (the residuary devisees and legatees under the will), the sum of $185,528.30. (Exhibit "D", stipulation of facts, Tr. pp. 49 to 54.)

On December 31, 1943, the assets of the estate had a value of $3,942,739.89, and the liabilities amounted to the sum of $1,104,886.70, and the amount of the excess of assets over the liabilities was the sum of $2,837,855.19. (Exhibit "T", stipulation of facts, Tr. pp. 103 to 106.)

The estate, other than the amounts which it owed for taxes, had only two creditors on December 31, 1942, one of whom was the widow, Jennie B. Zellerbach, and the other the Wells Fargo Bank & Union Trust Co.; the Wells Fargo Bank & Union Trust Co. would have consented to a distribution of the estate had such a request been made of it. (Testimony of Julius Eisenbach, Tr. pp. 128 to 134.)

The State of California would have consented to the distribution of all the income in 1942, notwithstanding that the inheritance taxes had not been paid. (Testimony of Richard O'Connor, Deputy Inheritance Tax Attorney for the State of California, Tr. pp. 123 to 128.)

It is the appellant's contention that at the time the respective distributions of income and corpus were made, the estate was in such condition that it could have been closed; that Jennie B. Zellerbach, the widow of decedent, as a matter of right was entitled to have distributed to her one-half of the income of the estate for each of the years 1942 and 1943, and that if either she or the Executors had petitioned the Probate Court for such distribution, it would have been granted (Testimony of Judge Timothy I. Fitzpatrick, Probate Judge who had charge of the estate of decedent, Tr. pp. 115 to 123); that if appellant's contentions are correct, then the appellant was entitled to a deduction in computing the net income of the estate for the years 1942 and 1943 of the full amount of the income which the estate either distributed to the legatees or could have distributed to the legatees, which was the entire net income of the estate for each of said years.

SPECIFICATIONS OF ERRORS.

The appellant relies upon the following specifications of errors which are set forth as assignments of errors on pages 173 and 174 of the Transcript of Record:

1. The failure of the Tax Court to allow as a deduction from the appellant's gross income for the year 1942 the full amount of appellant's income for the year 1942.

2. The failure of the Tax Court to allow as a deduction from the appellant's gross income for the year 1943 the full amount of appellant's income for the year 1943.

3. The failure of the Tax Court to find that the beneficiaries under decedent's Will had a present right to the 1942 income of the estate of the decedent.

4. The failure of the Tax Court to find that the beneficiaries under decedent's Will had a present right to the 1943 income of the estate of the decedent.

Note: The foregoing specifications of errors are discussed in the paragraphs having the following paragraph headings:

The Tax Court Erred in Failing to Allow as a Deduction from the Appellant's Gross Income for Each of the Years 1942 and 1943 the Full Amount of Appellant's Income for Each of Said Years. (Page 9.)

An Estate of a Decedent (Appellant Herein) Is Allowed An Additional Deduction in Computing the Net Income of the Estate, the Income Which Is Distributed to the Heirs or Legatees

or the Income Which in the Discretion of the Executors May Be Either Distributed or Accumulated. (Page 9.)

* * * * * * *

Residuary Legatees and Devisees Under the California Probate Law Are Entitled to Petition for a Distribution of Income During the Administration of the Estate. (Page 29.)

* * * * * * *

The Ordinary Duties Pertaining to the Administration of the Decedent's Estate Had Been Completed, and Accordingly It Is Deemed That the Estate Has Been Distributed and the Income Taxable to the Legatees. (Page 44.)

* * * * * * *

5. The failure of the Tax Court, in the alternative, to allow as a deduction from the appellant's gross income for the year 1942 the value of the property distributed to the legatees and devisees under decedent's Will during the year 1942 under the decree of partial distribution made and entered by the Probate Court during the year 1942.

6. The failure of the Tax Court, in the alternative, to allow as a deduction from the appellant's gross income for the year 1943 the value of the property distributed to the legatees and devisees under decedent's Will during the year 1943 under the decree of partial distribution made and entered by the Probate Court during the year 1943.

Note: Specifications of Errors Nos. 5 and 6 are discussed in the paragraph having the following paragraph headings:

Where a Distribution of the Corpus of An Estate Is Made in Any Year That the Estate Has Distributable Income, the Distribution Is Taxable to the Legatee to the Extent of the Distributable Income.

The Estate Having Distributed to the Residuary Legatees Corpus of a Value in Excess of Distributable Income, It Is Deemed That All Income Was Distributed to the Legatees. (Page 35.)

7. The findings of the Tax Court of a deficiency for the year 1942 in the amount of $1,768.55, in lieu of a determination that the appellant (taxpayer) is entitled to a refund for said year in the amount of $95,986.69, less the amount of $24,401.61, being the amount remaining unpaid on the assessment against the appellant (taxpayer) for said year, or a determination that the appellant (taxpayer) is entitled to a net refund of $71,585.08.

8. The finding of the Tax Court of a deficiency for the year 1943, in lieu of a determination that there is no income tax due from the appellant (taxpayer) for said year.

Note: The foregoing specifications of errors are matters of computation and can only be definitely determined after the decision of this Honorable Court.

ARGUMENT.

THE TAX COURT ERRED IN FAILING TO ALLOW AS A DEDUCTION FROM THE APPELLANT'S GROSS INCOME FOR EACH OF THE YEARS 1942 AND 1943 THE FULL AMOUNT OF APPELLANT'S INCOME FOR EACH OF SAID YEARS.

AN ESTATE OF A DECEDENT (APPELLANT HEREIN) IS ALLOWED AN ADDITIONAL DEDUCTION IN COMPUTING THE NET INCOME OF THE ESTATE, THE INCOME WHICH IS DISTRIBUTED TO THE HEIRS OR LEGATEES OR THE INCOME WHICH IN THE DISCRETION OF THE EXECUTORS MAY BE EITHER DISTRIBUTED OR ACCUMULATED.

The appellant contends, among other things, that under the provisions of Section 162 of the Internal Revenue Code, that the estate of the decedent (appellant herein) is allowed an additional deduction in computing the net income of the estate, the income which is distributed to the heirs or legatees, *or the income which in the discretion of executors may be either distributed or accumulated;* that notwithstanding the fact that Probate Court orders were not obtained authorizing the distribution of all of the income of the estate for the particular years involved in this appeal that under the particular facts in this case, the provisions of Section 162 of the Internal Revenue Code and the Commissioner's Regulations based upon this section, and which are hereinafter set forth at length, it will be deemed that such income was in fact distributed to the heirs or legatees, and accordingly the estate is entitled to a credit for the full amount thereof.

Section 162(b) of the Internal Revenue Code provides as follows:

"Sec. 162. *Net Income.* * * *

(b) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the legatees, heirs, or beneficiaries, but the amount so allowed as a deduction shall be included in computing the net income of the legatees, heirs, or beneficiaries whether distributed to them or not. As used in this subsection, 'income which is to be distributed currently' includes income for the taxable year of the estate or trust which, within the taxable year, becomes payable to the legatee, heir, or beneficiary. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under subsection (c) of this section in the same or any succeeding taxable year;"

Section 162 (c) of the Internal Revenue Code provides:

"Sec. 162. *Net Income.* * * *

(c) In the case of income received by estates of deceased persons during the period of administration or settlement of the estates, *and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated,* there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year, which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary;" (Italics ours.)

Section 29.162-1 of Regulations 111 relating to Income provides in part as follows:

> "From the gross income of the estate or trust there are also deductible * * * the following:
>
> (b) Any income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to a legatee, heir, or beneficiary, *whether or not such income is actually distributed.* For this purpose, it is provided in section 162(b) that 'income which is to be distributed currently' includes income of the estate or trust which, within the taxable year, becomes payable to the legatee, heir or beneficiary.
>
> (c) Any income of the estate of a deceased person for its taxable year which is properly paid or credited during such year to a legatee or heir, and any income either of such an estate or of a trust for its taxable year which is similarly paid or credited during that year to a legatee, heir or beneficiary *if there is vested in the fiduciary a discretion either to distribute or to accumulate such income.*" (Italics ours.)

Section 29.162-2(b) of the same Regulations provides in part:

> "As used in Section 162, the term 'income which becomes payable' means income to which the legatee, heir or beneficiary has a present right, *whether or not such income is actually paid.* Such right may be derived from the directions in the trust instrument or will to make distributions of an income at a certain date, *or from the exercise of the fiduciary's discretion to distribute income, or from a recognized present right under the local*

law to obtain income or compel a distribution of income." (Italics ours.)

We turn now to the evidence in this case and an analysis of the California Probate Code as applicable herein.

Section 956 of the California Probate Code provides as follows:

> "If all the debts have been paid by the first order for payment the court must direct the payment of legacies and a distribution of the estate among the persons entitled, as provided in the next chapter; but if there are debts remaining unpaid, or if, for other reasons, the estate is not in a condition to be closed, the administration may continue for such time as may be reasonable."

Section 1000 of the California Probate Code provides in part as follows:

> "At any time after the lapse of four months from the issuance of letters testamentary or of administration, the executor or administrator, or any heir, devisee or legatee, * * * may petition the court to distribute a legacy, devise or share of the estate, or any portion thereof, to any person entitled thereto, upon such person giving a bond as hereinafter provided * * *"

Section 1001 of the California Probate Code provides as follows:

> "If, at the hearing, it appears that the estate is but little indebted and that all inheritance taxes payable in said proceeding have been paid, or that

the State Controller, an inheritance tax attorney, or an assistant inheritance tax attorney has in writing consented to said distribution and the legacy, devise or share of the estate, or any portion thereof, may be distributed to the person entitled thereto, without loss to the creditors or injury to the estate or any person interested therein, the court shall make an order requiring the executor or administrator to deliver the legacy, devise or share of the estate or such portion thereof as the court may designate, to the person entitled thereto, upon receiving from such person a bond executed by him, and payable to the executor or administrator in such sum as the court may designate, with sureties to be approved by the judge, and conditioned for the payment, whenever required, of the proportion of the debts due from the estate, not exceeding the value or amount of the legacy or portion of the estate, so ordered to be delivered. When the time for filing or presenting claims has expired, and all uncontested claims have been paid or are sufficiently secured by mortgage or otherwise, and the court is satisfied that no injury can result to the estate, the court may dispense with the bond."

The evidence in this case shows that the decedent died August 7, 1941, and that his will was admitted to probate on September 2, 1941, and that on November 25, 1942, when the executors filed two petitions for partial distribution (Exhibits "G" and "I", stipulation of facts, Tr. pp. 62 to 65 and 68 to 72), more than one year had expired since the issuance of letters testamentary.

The evidence further shows that the estate, comparatively speaking, was little indebted; that the principal indebtedness was to the Wells Fargo Bank & Union Trust Co. of San Francisco, which indebtedness was amply secured. Julius Eisenbach, who was called as a witness by the petitioner, testified that he was Vice President of the Wells Fargo Bank & Union Trust Co., in charge of credits (Tr. p. 128); that in 1942, if the executors had requested the Wells Fargo Bank & Union Trust Co. for permission to distribute the estate without paying the loan, the bank would have consented. (Tr. p. 130.)

Richard C. O'Connor was another witness who testified on behalf of the petitioner. He testified he was a Deputy Inheritance Tax Attorney for the State of California, connected with the State Controller's Office of the State of California, which office has charge of inheritance taxes for the State of California, and that as such Deputy Inheritance Tax Attorney, he had under his jurisdiction in 1942 the Estate of Isadore Zellerbach, deceased (Tr. p. 124); that if a request had been made to his office in 1942 for a distribution of the entire income of the estate for the year 1942, without the payment of the inheritance taxes that his office would have consented to such distribution. (Tr. pp. 125 to 126.)

A partial distribution may be made without payment of inheritance taxes if the State Controller, an

Inheritance Tax Attorney or an Assistant Inheritance Tax Attorney consents to such distribution in writing.

California Probate Code, Section 1001;

Estate of Johnson, 218 Cal. 501, p. 504;

Estate of Webster, 60 Cal. App. (2d) 524, p. 528.

As hereinafter appears, the State Controller did give his consent to the distributions which were made.

The will of the decedent directs that the residue of the estate of the decedent be distributed three-sixths to decedent's widow, Jennie B. Zellerbach, and three-sixths to decedent's children, one-sixth to each. (Exhibit "A", stipulation of facts, Tr. p. 34.) Based upon these provisions of the will, the executors filed their petitions for a partial distribution of the income in 1942 and 1943 (Exhibits "G" and "Q", stipulation of facts, Tr. pp. 62 to 65; Tr. pp. 93 to 96) and the decrees of partial distribution were based on these provisions of the will, namely, three-sixths of the income was distributed to the children. (Exhibits "H" and "R", stipulation of facts, Tr. p. 66 and pp. 97 to 99.) With respect to the decree made on December 7, 1942, (Exhibit "H", stipulation of facts, Tr. p. 66) as we pointed out, an arbitrary amount of $22,000.00 was distributed to the widow, whereas in the decree made on December 13, 1943 (Exhibit "R", stipulation of facts, Tr. pp. 97 to 99) no amount whatsoever was distributed to the widow.

At this time we would like to call particular attention to the following language which appears in the

decree of December 7, 1942 (Exhibit "H", stipulation of facts, Tr. pp. 66 to 67), and which appears in substantially the same form in each and every other decree of partial distribution.

> "The Court, after hearing the evidence, finds that all the allegations of said petition are true; that the time for filing claims against said estate has expired; that all claims which have been filed have been allowed, approved and paid; that the federal estate tax, as shown by the return, has been paid; that the State Controller of the State of California has consented in writing to the said distribution; that all personal property taxes due and payable by said estate have been paid; that the distribution prayed for in said petition may be allowed as therein prayed for without injury to said estate or any person interested therein, and that after said distribution sufficient assets will remain in the hands of the executors to pay all debts and expenses of administration;"

The Court having made such a finding and having distributed one-half of the income in both 1942 and 1943 to the children, we contend that if either the executors or the widow had petitioned in each of said years to distribute the full one-half of the income to the widow for each of said years, it would have been mandatory for the Court to have granted such petitions.

In support of this contention, we call attention to a comparatively recent decision of the California District Court of Appeal for the Second District (hearing denied by California Supreme Court) entitled "*Es-*

tate of Henry S. Stephenson, deceased", reported in 65 Cal. App. (2d) 120, wherein the Court states on page 123 of the opinion:

> "The proceedings for partial distribution of an estate prior to final distribution have been authorized at all times since the establishment of the probate courts in California. The provisions now in effect on the subject are sections 1000 and 1001 of the Probate Code. *It is made mandatory by section 1001 that the court make the order of distribution,* for it is there provided that if it appears that the estate is but little indebted and that inheritance taxes have been paid and that the distribution of the portion of the estate may be made without loss to creditors or injury to others 'the court shall make an order' for the delivery of the share of the estate or such portion thereof as the court may designate to the person entitled thereto.
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> * * * * * * *
>
> *"The Probate Code clearly gives power to the court to order a partial distribution of an estate and, given the prescribed conditions, it is made mandatory upon the court to make the order."* (Italics ours.)

See also the leading case of *In re Crocker,* 105 Cal. 368, at page 371, where the California Supreme Court stated:

> "The finding by the court that the estate was but little indebted is objected to by appellants upon the ground that these words are intended to 'operate only where, as a matter of fact and absolutely, the estate, no matter what its size, was but little indebted.' These statutory words were

> intended to be used relatively, and not absolutely, and they merely refer to a 'condition of things in which the debts are small when considered in connection with the value of the estate.' Hence, it follows that the contention of appellants on this point cannot be sustained."

To the same effect, see:

Estate of Chesney, 1 Cal. App. 30, at p. 34.
Estate of Hinkel, 176 Cal. 563, at p. 566.

We also call attention to the testimony of Judge Timothy I. Fitzpatrick, the Probate Judge, in whose court and under whose jurisdiction the decedent's estate was being probated. He testified that if petitions had been presented to him in 1942 and 1943 by the executors or the legatees for the distribution of the entire income of the estate for each of said years, he would have granted such petitions. (Tr. pp. 115 to 122.)

The Tax Court in its opinion, in discussing the foregoing case of the *Estate of Henry S. Stephenson, deceased,* supra, states as follows:

> "It is true that in the case of In Re Stephenson's Estate, 150 Pac. (2d) 222, upon which petitioners primarily rely, it is stated that 'It is made mandatory by section 1001 that the court make the order of distribution.' The court, however, immediately modifies that statement for it continues as follows:
>
> * * * for it is there provided that if it appears that the estate is but little indebted and that inheritance taxes have been paid and that the distribution of the portion of the estate may be made

without loss to creditors or injury to others 'the court shall make an order' for the delivery of the share of the estate or such portion thereof as the court may designate to the person entitled thereto. * * *

The Probate Code clearly gives power to the court to order a partial distribution of an estate and, given the prescribed conditions, it is made mandatory upon the court to make the order. But to exercise that power accurately it is necessary that it first be determined what persons are entitled to the order and what portion or portions of the estate should be distributed to them. * * *

The court thus recognizes that the mandate is subject to certain conditions so that in the last analysis the order of distribution is subject to the judgment and discretion of the Probate Court.

The beneficiaries had no present right to the 1942 and 1943 income. They merely had a potential right thereto, which, as to the amount in dispute, was neither recognized nor enforced. The 1942 and 1943 income of the estate was not income of the estate 'to be distributed currently' as provided in section 162 (b). Estate of Andrew J. Igoe, 6 T. C. 639."

However, we point out, with all due respect to the Tax Court, that it overlooked three very important facts which were present in the Estate of Isadore Zellerbach (appellant herein), and which facts no longer gave the Probate Court any discretion with reference to the petitions for partial distribution but would have made it mandatory to grant said petitions.

First, as we have already pointed out, in the decrees of partial distribution by which a portion of the income was distributed in both the years 1942 and 1943, the court found that the time for filing claims against the estate had expired; that all claims which had been filed had been allowed, approved and paid; that the federal estate tax, as shown by the return, had been paid; that the State Controller had consented in writing to the distribution; that all personal property taxes due and payable by the estate had been paid, and that the distribution prayed for in the petition could be allowed as prayed for therein without injury to the estate or any person interested therein, and that after the distribution sufficient assets would remain in the hands of the executors to pay all debts and expenses of administration.

Accordingly, the Court made a finding on every point which would be necessary for it to have exercised its discretion, but having found as it did it no longer had any discretion to exercise, and the duty became mandatory upon the Probate Court to make the partial distribution. This is clearly illustrated by the language of the decision *In re Stephenson, supra,* quoted by the Tax Court, wherein the California District Court of Appeal stated: "and, given prescribed conditions, it is made mandatory upon the court to make the order."

See also *Estate of Clifford,* 16 Cal. App. (2d) 123, wherein the Court states, at pages 126-127:

"It is ordinarily true that all proper issues of facts joined in probate proceedings like any civil action must be determined and that the court should adopt appropriate findings respecting such issues. (Sec. 1230, Probate Code; *Estate of Pendell,* 216 Cal. 384 [14 Pac. (2d) 506]; *Estate of Exterstein,* 2 Cal. (2d) 13 [38 Pac. (2d) 151]; 11A Cal. Jur. 171, sec. 104; 11B Cal. Jur. 707, sec. 1228.) In the order for partial distribution which was signed and filed in this proceeding the court did find:

'That all inheritance taxes due from the distributees and all personal property taxes due and payable by the estate, have been paid; and that said estate is but little indebted, and that the share of the petitioner asked for may be allowed to him without loss to creditors of the estate, and that no injury can result to the estate therefrom, * * *

'It is ordered * * * that the said Gladys Vice, as the administratrix with the will annexed of said estate, forthwith deliver to E. E. Keyes * * * the following described property, to-wit, the sum of One Thousand Dollars, * * *'

The preceding findings include a determination of all the ultimate facts which are required by sections 1000 and 1001 of the Probate Code on a petition for partial distribution."

All the prescribed conditions were present in the Estate of Isadore Zellerbach. If the executors had petitioned for the distribution of the entire income in 1942 instead of only a portion of the income, the prescribed conditions would not have changed because, as

the record shows, on the very same day that the executors filed a petition for partial distribution of $181,000 in income out of a total of $317,000 income for said year (Tr. pp. 62 to 65), they filed a petition for a partial distribution of corpus of the trust estate (Tr. pp. 68 to 72), which corpus it was agreed had a fair market value on the date it was distributed of $1,146,000. (Paragraph 25, stipulation of facts, Tr. p. 28.) The decree distributing the income was made on December 7, 1942 (Tr.. pp. 66 to 68), and by that decree of distribution the $181,000 of income was there distributed arbitrarily to the widow $22,000, and the balance was distributed $53,000 to each of the children, the latter amount representing one-sixth of the estimated income for the year 1942, each of the children being entitled to one-sixth of the residue of the state. (Tr. p. 67.) On the other hand the corpus of the trust estate which was distributed on December 8, 1942 was distributed one-half to the widow and one-sixth to each of the children, which was in accordance with the will. (Tr. p. 74.)

Secondly, it is axiomatic that if the executors or Jennie B. Zellerbach had petitioned the Probate Court for a distribution of one-half of the full income of the esate for the year 1942, after the decree for partial distribution had been made, that the Probate Court would have had no alternative but to have granted such petition, as it could not make a distribution to some of the residuary legatees of their proportionate share of the income and refuse to grant

another residuary legatee her proportionate share of the income on like terms.

Practically the same situation prevailed for the year 1943. On November 30, 1943, it was estimated that the income of the estate for the year 1943 was the sum of $191,500, and on that day the executors filed a petition to distribute one-half of that income to the three children, share and share alike, and did not request the distribution of any of the income to the widow who was entitled to the other one-half thereof. (Tr. pp. 93 to 97.) On December 13, 1943, the Probate Court made an order distributing the income as prayed for in said petition, and made the same findings as it had in its previous decrees of partial distribution. (Tr. pp. 97 to 99.)

However, during the earlier part of the year 1943 when the executors had desired to distribute a part of the corpus of the trust estate, they petitioned to distribute it one-half to the widow and one-sixth to each of the children. (Petition for partial distribution filed June 18, 1943, Tr. pp. 80 to 83; petition for distribution filed August 4, 1943, Tr. pp. 87 to 90.) The decree for partial distribution granting these petitions, distributed this property in accordance with the prayer of the respective petitions. (Tr. pp. 84 to 86, and 91 to 93.)

In view of the foregoing, we submit that the record in this case shows, without question, that Jennie B. Zellerbach, decedent's widow, had a "present right" in both 1942 and 1943 to one-half of the entire income

of the estate for each of said years, and that such right came both from the executors' discretion to distribute income and from the probate law of the State of California. That she recognized such right is evidenced by the fact that on January 24, 1944, she filed an amended income tax return for the year 1942, wherein she reported as having been distributed to her one-half of the income for the Estate of Isadore Zellerbach for the year 1942 (Paragraph 28, stipulation of facts, Tr. p. 29), and in her income tax return for the year 1943 she included one-half of the income of the estate for said year. (Paragraph 29, stipulation of facts, Tr. p. 29.)

The third point we urge is that the fact that the income was not paid to Jennie B. Zellerbach does not alter the situation, for as we have already pointed out, Section 29.162-2(b) of the Regulations provides in part as follows:

> "As used in Section 162, the term 'income which becomes payable' means income to which the legatee, heir, or beneficiary has a present right, whether or not such income is actually paid. Such right may be derived from the directions in the trust instrument or will to make distributions of income at a certain date, or from the exercise of the fiduciary's discretion to distribute income, or from a recognized present right under the local law to obtain income or compel a distribution of income."

We would also like to call attention to the language of the Tax Court in the case of *Mary Pyne Filley v.*

Commissioner, 45 B.T.A. 826, which while a trust case and prior to the adoption of the 1942 amendment, nevertheless contains language which we contend strongly supports our contentions. We quote in part from the opinion starting at page 829, as follows:

> "It is provided in section 162(b) of the Revenue Act of 1936 that a trust shall be allowed a deduction of the amount of the income of the 'trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries', and in Section 162(c) that 'in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated', the amount which is properly paid or credited during such year to the beneficiary shall be allowed as a deduction. The amount allowed as a deduction under either of the above provisions is required to be included in computing the net income of the beneficiary. The Commissioner has made his determination upon the theory that the income of each trust was taxable to the beneficiary under Section 162(b) as income which was to be distributed currently by the fiduciary to the beneficiary. Actual receipt by the beneficiary during the taxable year is not essential under that provision. Cf. *Freuler v. Helvering,* 291 U. S. 35; *Willcuts v. Ordway,* 19 Fed. (2d) 917. The petitioner contends that the trustee had the discretion to accumulate the income of this trust or to distribute it to the beneficiary, consequently, (c) applies, and, since none of the income was actually paid to the beneficiary during the year, none of it is taxable to the petitioner. Although the proof does not show that the income was not properly credited to the peti-

tioner during the year, decision need not turn upon this failure of proof.

'Accumulated' in (c) is used in opposition to 'distributed currently' in (b). The latter is intended to cover all cases where the trust instrument imposes a duty upon the trustees to make a prompt or periodic distribution of the trust income to the beneficiary. *Commissioner v. Stearns,* 65 Fed. (2d) 371; *Commissioner v. First Trust & Deposit Co.,* 118 Fed. (2d) 449, affirming 41 B.T.A. 107; *Freuler v. Helvering,* supra; *Florence M. Smith, Executrix,* 5 B.T.A. 225. Cf. *Albert J. Appell et al., Executors,* 10 B.T.A. 1225. (c), by its express terms, covers only those cases where the fiduciary has the right and the duty to choose between prompt distribution and accumulation beyond the time when a prompt distribution would normally have been made. Discretion requires the exercise of judgment and reason. It involves consideration of whether, on the one hand, there is good reason to distribute and no justification for withholding, or whether, instead, he should deliberately refrain from distributing at the usual time and withhold for some definite reason which, in his opinion, better carries out the purpose of the trust than would a current distribution. A provision for the distribution of 'net' income does not make (b) inapplicable. This is so even though distribution is not to be made until after the close of the year in which the income is earned by the trust. Income which is distributed annually is being distributed currently, as well as promptly and periodically, and comes within (b), upon authority of the cases above cited. The grantor in the present case did not intend that the income of

either trust should be accumulated within the meaning of that word as it is used in (c), but intended that the income should be distributed currently to the beneficiary within the meaning of (b). This is apparent from the words he used in the trust instruments. Similar words have been similarly interpreted. Cf. *Leo A. Balzereit et al., Guardians,* 38 B.T.A. 345; affd., 107 Fed. (2d) 1008; *Leonard Marx,* 39 B.T.A. 537; *Sewell v. United States,* 19 Fed. Supp. 657. The only discretion given under the two trusts here in question was a discretion to the trustees of the *inter vivos* trust to pay the income directly to the beneficiary or to apply the same to her use and benefit. That is not a discretion to accumulate within the trust and is not the kind of discretion which brings the case within (c). The income was not to be accumulated, but was to be distributed currently, either directly to the beneficiary or for her use and benefit. It is taxable to the beneficiary."

In *Estate of Andrew J. Igoe v. Commissioner,* 6 T. C. 639, income was credited on the books of the estate to the beneficiaries who were the residuary legatees under the decedent's will. Although the income was not paid, it was reported by each beneficiary in his income tax return and the executors deducted the amounts so credited from the income of the estate. The petitioners contended that the entire net income of the estate was "constructively paid" to the beneficiaries as provided in Section 162(c) of the Internal Revenue Code. They agreed that the sums placed to their credit on the books of the estate were

both legally and practically available upon demand. The Tax Court, speaking through Judge Van Fossan, sustained the petitioners' contention.

We therefore submit that in view of the record in the instant case, the Tax Court clearly erred when it stated in its opinion that "The beneficiaries had no present right to the 1942 and 1943 income. They merely had a potential right thereto, which, as to the amount in dispute, was neither recognized nor enforced. The 1942 and 1943 income of the estate was not income of the estate 'to be distributed currently' as provided in Section 162(b)." (Tr. p. 152.)

We believe the Tax Court completely overlooked the provisions of Section 29.162-1 of Regulations 111, and Section 29.162-2b of the same regulations.

We can see no appreciable difference between the *Igoe* case, *supra,* and the case at bar, although the opinion of Judge Fossan in the instant case attempts to draw a distinction. The executors, by setting forth in their petitions for partial distribution that they had certain amounts of income available for distribution and petitioning for and being granted the right to distribute one-half of the income pro rata to the children who, as residuary legatees, were collectively entitled to one-half of the residue of the estate, *ipso facto* admitted that they were holding the other half of the income for the use and benefit of the widow who was the other residuary legatee.

It needs no citation of authority to the effect that executors may not discriminate in favor of one resid-

uary legatee as against another. The income was "available" to the widow on demand, and as we pointed out above, if she had petitioned the Court to distribute it to her, it would have been mandatory for the Court to have so distributed it to her. That she "acquiesced" in such action is evidenced by the fact that she included all of the income that she was entitled to receive in both her 1943 income tax return and her amended return for 1942. The income had been credited to her, it was available to her and would have been paid either if she or the executors had asked for formal permission to distribute it.

In view of the foregoing, we respectfully submit that the estate is entitled to a credit for the full amount of the distributable income for the years 1942 and 1943, and the Tax Court erred in disallowing such deductions. We will, however, set forth additional grounds which, in our opinion, entitles the estate to such credits.

RESIDUARY LEGATEES AND DEVISEES UNDER THE CALIFORNIA PROBATE LAW ARE ENTITLED TO PETITION FOR A DISTRIBUTION OF INCOME DURING THE ADMINISTRATION OF THE ESTATE.

In the preceding paragraphs we pointed out the distributions of income that had been made during the course of the administration of the estate. We now will cite the authority for distributions of income during the course of such administration.

The record in this case shows that prior to November 25, 1942, all gifts and legacies under the de-

cedent's will had been paid (Exhibits "E", "F", and "G", stipulation of facts, Tr. pp. 55-65) and that the only estate that remained undistributed was the residue.

Under the California Probate Code, Section 300, the title to a decedent's property, both real and personal, passes to the person to whom it is devised or bequeathed by his last will and testament, subject to the possession of the executor and the control of the Superior Court for the purposes of administration, sale or other disposition as provided in the Probate Code, and is chargeable with the expenses of administering his estate, and the payment of his debts and the allowance to the family. (See *Noble v. Beach,* 21 Cal. (2d) 91, p. 94; *Reed v. Hayward,* 23 Cal. (2d) 336, p. 340.)

In General Counsel's Memorandum 22034-25-10297, page 3, Mr. Wenchel, the then chief counsel for the Bureau of Internal Revenue, states in part as follows:

> "Advice is requested whether in the case of the estate of A, which was in process of administration during the year 1938, the income, including gains on the sale of capital assets realized and distributed by the executor in the year 1938, is taxable to the estate or to the distributees.
>
> A died testate on April ....., 1938, a resident of the State of California. After providing for several specific bequests and the payment of his debts, the testator directed that the residue of the estate be divided into a specified number of equal parts and distributed to certain named persons. During the period from April ....., 1938 to Decem-

ber 31, 1938, the estate had a net taxable income of 17x dollars, including capital gains of 13x dollars derived from the sale of corpus of the estate. On November ....., 1938 the probate court ordered a payment of 55x dollars to residuary legatees, the order expressly providing that 17x dollars be paid out of income and the balance out of corpus. Payments were made by checks dated November ....., 1938 and on the income tax return filed for the estate a deduction was claimed for the amount of the payments from income. A's will made no provision for the distribution of income during the period of administration. Furthermore, with the exception of Section 1000 of the Probate Code of California, which permits any heir, devisee, or legatee to petition for a distribution after four months, the code of the State is silent regarding the distribution of income of an estate during administration.

Section 162(c) of the Revenue Act of 1938 provides in part as follows:

'In the case of income received by estates of deceased persons during the period of administration or settlement of the estate * * * there shall be allowed as an additional deduction in computing the net income of the estate * * * the amount of the income of the estate * * * for its taxable year, which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatees, heir, or beneficiary.'

In General Counsel's Memorandum 4596 (C.B. VII-2, 133 (1928) it was held (syllabus):

'Where a will is silent as to the disposition of income received during the period of administration, the laws of the particular State involved must be considered in order to determine whether current income or gain on sales of property may be "properly" paid or credited to residuary or other legatees during any given taxable year.'

It was stated in the last paragraph of that memorandum that 'Unless the will or the laws of the State make such payment or credit improper the amount paid or credited is deductible in computing the net income of the estate.'

Under the facts in the present case, it is the opinion of this office that the distribution directly to the beneficiaries of income, including capital gains, by the executor of the estate of A during the period of administration of the estate are deductible by the estate for Federal income tax purposes as income 'properly paid' under the provisions of Section 162(c) of the Revenue Act of 1938. Such income is taxable to the beneficiaries."

In the *Estate of Bernal,* 165 Cal. 223, where one of the questions involved was the determination as to who was entitled to rents and profits during administration of a parcel of land devised to certain persons, the California Supreme Court stated, at page 235:

"What we have said not only establishes the merit of the claim of the grandchildren as to the balance remaining unpaid on the mortgage debt and interest accruing thereon, but also disposes of the claim of the son that he is entitled to a credit on account of the one thousand five hundred dollars already paid on account of the prin-

cipal of the mortgage debt. It further practically establishes as valid the claim of the grandchildren in regard to the rents and profits derived from the land. The title to the real property devised to them vested in them at the moment of the death of the testatrix, subject only to the possession of the executor for purposes of administration, including the payment of expenses of administration and debts in the order prescribed by law, in view of the provisions of the will. It was said in *Estate of Woodworth,* 31 Cal. 600: 'That is to say that the rents of the real estate accruing subsequent to the death of the testator, for the purpose of marshalling the assets, should be regarded as belonging to the realty from which they were derived. Such was the rule at common law, and no change in this respect appears to be intended.' There is nothing in our statutes, so far as we have found, that is contrary to this view. We think the discussion in *Estate of Woodworth,* 31 Cal., at pages 604 and 605, sufficiently shows that this is true. The executor holds *all* the property of the estate for purposes of administration, including not only the rents and profits of land specifically devised, but the land itself, and all of this property is subject, if necessary, to disposition for the payment of expenses and debts. But in such a case as the one before us, we must primarily resort to a certain portion of the property of the deceased for such purposes, and cannot resort to the other portion until the *primary fund for such purposes is exhausted.* And here such primary fund is that given to the residuary legatees. As between him, he being the only other person interested in the estate, and the grandchildren, the

> net rents and profits of the real property specifically devised to the children, accruing since the death of deceased, are a part of such realty, and, there being sufficient other property to pay all debts and expenses in full, should have been awarded to the grandchildren. It was not, as between the son and the grandchildren, a proper application of any part thereof to pay the same on account of interest on the mortgage or on account of any expense of administration or debt of deceased." (Italics ours.)

In the *Estate of Matthiessen,* 23 Cal. App. (2d) 608, p. 614, the Court ordered rents of property which had been collected by an executor during administration, paid to a devisee, the estate being solvent.

As we have several times pointed out, the assets of the estate, the "primary fund", were ample to pay all indebtedness of the estate, including all unpaid taxes. Accordingly, the residuary legatees in whom the title to the residue of the estate, as well as the title to the undistributed income, was vested, could petition at any time during 1942 and 1943 to have the income distributed to them in the proportions that they took under the will and by reason thereof, such income was income to which they had a present right which was not needed in the administration of the estate. By reason thereof, Jennie B. Zellerbach was required, under the provisions of the Internal Revenue Code and the Regulations, to include one-half of the entire distributable income for each of said years in her income tax return and the estate was entitled to a deduction therefor.

This is particularly true in view of the distribution of income on December 7, 1942, corpus on December 8, 1942, and again income on December 13, 1943.

WHERE A DISTRIBUTION OF THE CORPUS OF AN ESTATE IS MADE IN ANY YEAR THAT THE ESTATE HAS DISTRIBUTABLE INCOME, THE DISTRIBUTION IS TAXABLE TO THE LEGATEE TO THE EXTENT OF THE DISTRIBUTABLE INCOME.

THE ESTATE HAVING DISTRIBUTED TO THE RESIDUARY LEGATEES CORPUS OF A VALUE IN EXCESS OF DISTRIBUTABLE INCOME, IT IS DEEMED THAT ALL INCOME WAS DISTRIBUTED TO THE LEGATEES.

An additional point urged by the appellant, as entitling it to a deduction for the year 1942 of the full amount of the income for that year, was the fact that in 1942 the executors distributed to the legatees and devisees, in addition to the income actually distributed, corpus of a value in excess of the distributable income and in 1943 corpus of the value of $30,950.00.

Paragraphs 25, 26 and 27 of the stipulation of facts state as follows:

> "(25) That the fair market value at the time of distribution of the property, distributed to the legatees of the decedent by the order and decree for partial distribution of the Probate Court, made on December 8, 1942, Exhibit J attached hereto, was the sum of $1,146,000.00." (Tr. p. 28.)
>
> "(26) That the fair market value at the time of distribution of the property, distributed to the legatees of the decedent by the order and decree

for partial distribution of the Probate Court, made on July 7, 1943, Exhibit N attached hereto, was the sum of $27,500.00." (Tr. p. 29.)

"(27) That the fair market value at the time of distribution of the property, distributed to the legatees of the decedent by the order and decree for partial distribution of the Probate Court, made on August 18, 1943, Exhibit P attached hereto, was the sum of $3,450.00." (Tr. p. 29.)

Section 162(d)(1) of the Internal Revenue Code provides in part as follows:

"Sec. 162(d).

(d) RULES FOR APPLICATION OF SUBSECTIONS (b) AND (c)—For the purposes of subsections (b) and (c)—

(1) AMOUNTS DISTRIBUTABLE OUT OF INCOME OR CORPUS—In cases where the amounts paid, credited, or to be distributed can be paid, credited, or distributed out of other than income, the amount paid, credited, or to be distributed (except under a gift, bequest, devise, or inheritance not to be paid, credited, or distributed at intervals) during the taxable year of the estate or trust shall be considered as income of the estate or trust which is paid, credited, or to be distributed if the aggregate of such amounts so paid, credited, or to be distributed does not exceed the distributable income of the estate or trust for its taxable year. If the aggregate of such amounts so paid, credited, or to be distributed during the taxable year of the estate or trust in such cases exceeds the distributable income of the estate or trust for its taxable year, the amount so paid,

> credited, or to be distributed to any legatee, heir, or beneficiary shall be considered income of the estate or trust for its taxable year which is paid, credited, or to be distributed in an amount which bears the same ratio to the amount of such distributable income as the amount so paid, credited, or to be distributed to the legatee, heir, or beneficiary bears to the aggregate of such amounts so paid, credited, or to be distributed to legatees, heirs, and beneficiaries for the taxable year of the estate or trust.''

It is the appellant's contention that, irrespective of any other factor in this case, in view of the fact that there was distributed to the residuary legatees in 1942 property of a fair market value of $1,146,000.00 and the distributable income of said estate for said year was $324,209.38, that the entire distributable income for the year 1942 is deductible by the estate by reason of the foregoing provisions of Section 162(d)(1) of the Internal Revenue Code.

Subsection (d) was added to Section 162 of the Internal Revenue Code by Section 111(e) of the Revenue Act of 1942. It is our contention that the foregoing provisions of subdivision (d) were enacted to cover a situation like the instant case, namely, where an estate has distributable income which, at its discretion, may be distributed or accumulated and it distributes corpus in excess of the amount of its distributable income to the persons who are entitled to such income, that it will be deemed that the entire income was distributed to the legatees entitled thereto, notwithstanding such income was not acutally paid.

It is somewhat analogous to a distribution by a corporation of its capital to its stockholders which is deemed a distribution out of earnings or profits to the extent thereof. (Sec. 115(b), Internal Revenue Code.)

In General Counsel's Memorandum 24702, 1945-19-12141 (p. 9) an opinion was given with respect to whether amounts distributed by an estate out of its income during the taxable year in which the residue becomes payable are taxable to the legatee and deductible by the estate under Section 162(b) of the Internal Revenue Code, as amended by Section 111 of the Revenue Act of 1942, where such income is considered principal to the legatee under State law.

We quote from the last portion of this opinion as follows:

> "The general statutory plan with respect to estates has been to tax in some way the whole net income of the estate (*Helvering v. Julia Butterworth, et al.,* 290 U. S. 365, Ct. D. 769, C. B. XIII-1, 151 (1934) (3 U.S.T.C. Sec. 1193)), that is, the income is either taxed to the estate as a separate entity or to the legatee to whom the income is paid. The basic principle underlying Section 111 of the Revenue Act of 1942 is to impose the tax, with stated limitations, upon the person who enjoys the income (the residuary legatee) and still preserve the nontaxability of pecuniary legatees with respect to estate income used to discharge lump-sum bequests. Thus, under Section 162(b) of the Code, as amended, the amounts distributed to the residuary legatee (including a trust-legatee) during the taxable year

in which the residue becomes payable, to the extent the estate has income for such taxable year, would represent income to the residuary legatee.

Senate Report No. 1631, Seventy-seventh Congress, second session (C. B. 1942-2, 504, at page 559), states in part as follows:

'Your Committee bill adds an amendment to Section 162(b) of the Code designed to include in the income of a legatee or beneficiary the income of the estate or trust for its taxable year which, within such taxable year, becomes payable to the legatee or beneficiary, even though it then becomes payable as part of an accumulation of income held until the happening of some event which occurs within the taxable year. Such cases are usually cases where accumulated income of an estate is paid to a residuary legatee upon termination of the estate or where income of a trust is accumulated for distribution upon the beneficiary's reaching a specified age.'

Although it is not expressly stated that the provisions of Section 162(b) of the Code, as amended, should be applied without regard to State law, it is inferred that such was the Congressional intent, for it seems clear that Congress intended to change the rule laid down in the *Durkheimer* case, *supra,* and in similar cases, so that the amount paid to the residuary legatee would be taxable to the legatee to the extent that the estate had income for the taxable year in which the residue became payable, irrespective of the fact that under the law of most States such income would be considered an addition of principal to the residue. (See Section 29.162.2(b) of Regulations 111.)

> Accordingly, it is the opinion of this office that amounts distributed by an estate out of its income during the taxable year in which the residue becomes payable are, to the extent the estate had income (other than income in respect of a decedent) for such taxable year, taxable to the legatee and deductible by the estate under Section 162(b) of the Internal Revenue Code, as amended by Section 111 of the Revenue Act of 1942, regardless of the fact that under State law such income is considered principal to the legatee, except where the distribution is made in satisfaction or payment of a pecuniary legacy. (See *Old Colony Trust Co. et al. v. Commissioner,* 38 B. T. A. 828 (CCH Dec. 10, 458), and *Arthur H. Wellman v. Welch,* 99 Fed. (2d) 75 (38-2 U.S.T.C. Sec. 9508), with respect to the exception.) Signed by J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue.)"

In *Almira A. Wick v. Commissioner* (Memorandum Decision) Docket No. 109506, entered January 15, 1943; 1 Tax Court Memorandum Decisions 434, the Tax Court held that amounts paid a legatee before final distribution where the executors had discretion whether to distribute income or accumulate the income was a distribution of income within the intendment of Section 162(c) of the Revenue Act of 1938 (now Internal Revenue Code) even though the same was marked as on account distribution and the source of the funds came from an account in which both corpus and income were commingled.

If appellant's contention as above set forth is not correct, it would be comparatively simple to dis-

tribute corpus to the legatees, keep the income in the estate, and thus avoid distributing the income to the legatees, which in many instances may be most desirable. This was the practice before 1942 and why we contend that the 1942 amendment was designed to correct this evil. Finally, in connection with this subject matter we quote in part Section 29.162-2(a) of the Regulations:

> "The method of allocating income of the estate or trust for its taxable year in cases to which section 162(d)(1) applies is as follows: The aggregate of all amounts which can be paid, credited, or distributed out of other than income (except under a gift, bequest, devise, or inheritance not to be paid, credited, or to be distributed at intervals) is obtained. The aggregate of such amounts is considered to be paid, credited, or distributed in such cases out of income of the estate or trust for its taxable year if it does not exceed the distributable income of the estate or trust for its taxable year. If the aggregate of such amounts does exceed the distributable income of the estate or trust for its taxable year, the portion of such amount paid, credited, or to be distributed to a legatee or beneficiary is considered income of the estate or trust for its taxable year which is paid, credited, or to be distributed in an amount which bears the same ratio to the amount of all distributable income as the amount so paid, credited, or to be distributed to the legatee or beneficiary bears to the aggregate of such amounts so paid, credited, or to be distributed to such legatees or beneficiaries for the taxable year of the estate or trust. The propor-

> tion stated in the preceding sentence applies only to legatees or beneficiaries of amounts which can be paid, credited, or distributed out of other than income of the estate or trust and, in computing such proportion, the amount of any gift, bequest, devise, or inheritance not to be paid, credited, or distributed at intervals is not to be included."

The Tax Court held that Section 162(d) of the Internal Revenue Code did not apply because "the bequest and devise of the residuary estate herein is a bequest and devise 'not to be paid, credited or distributed at intervals' ".

While the decedent's will did not provide that bequests and devisees were to be paid at intervals, the California Probate Code, in effect, made them payable at intervals because Section 1000 of the Probate Code providing for partial distribution after four months and Section 1010 providing for ratable distribution when the time for filing or presenting claims has expired (six months) are, to all intents and purposes, written into the will.

The Tax Court in discussing Section 162(d) of the Internal Revenue Code quotes from a portion of the report of the Ways and Means Committee of the Seventy-seventh Congress, Second Session. This quotation appears at page 156 of the Transcript of Record and reads as follows:

> "As a complement to the amendment of section 22(b)(3) and for purposes of clarity, section 162 of the Code is also amended by adding a new sub-

section designated as '(d)'. This subsection provides a formula for allocating income of an estate or trust to legatees and beneficiaries in order to make the source of distribution clear and to prevent tax avoidance by distributions claimed to be other than out of income or out of income other than income for the current taxable year. It is immaterial under the rule stated in section 162(d) whether income is used to make the distribution, whether such distribution may, in the discretion of the fiduciary, be made out of other than income, or whether the terms of the will or trust instrument direct that amounts other than income be used to assure the beneficiary the payment of a specified sum at stated intervals. * * *"

The Tax Court also refers to Section 29.162-2 of Regulation 111 which deals with Section 162(d)(1) and which we have quoted above.

We submit that the foregoing quotation from the Ways and Means Committee Report and the Regulations referred to directly supports the appellant's contention and that the Tax Court erred when it stated:

> "From the foregoing it is obvious that amounts paid out of corpus on a bequest and devise as herein involved are not within the purpose and scope of subsection (d)."

And also erred when it stated:

> "Since the bequest and devise of the residuary estate herein is a bequest and devise 'not to be paid, credited or distributed at intervals', subsection (d) of section 162 is not applicable."

For the foregoing additional reasons we contend, and respectfully submit, that the estate having distributed corpus in 1942 and 1943 to the extent that it had distributable income, it will be deemed a distribution of income.

THE ORDINARY DUTIES PERTAINING TO THE ADMINISTRATION OF THE DECEDENT'S ESTATE HAD BEEN COMPLETED, AND ACCORDINGLY IT IS DEEMED THAT THE ESTATE HAS BEEN DISTRIBUTED AND THE INCOME TAXABLE TO THE LEGATEES.

We have heretofore shown that in both 1942 and 1943 the estate was in such condition that at the election of the executors the entire estate could have been distributed and wound up. There were sufficient assets on hand to discharge all the obligations of the estate. The only matter that remained uncompleted was the determination, if any, of a deficiency in federal estate taxes arising out of a dispute between the executors and the Treasury Department as to the valuations of certain stocks in the estate under the so-called "blockage rule". The maximum amount of such liability was known. This was all that remained to be done in the estate and the estate could have been distributed to the legatees subject to the payment of any deficiency in federal estate taxes or the executors could have reserved a sufficient amount to cover the maximum liability therefor. (*Estate of Johnson,* 218 Cal. 501, p. 504.)

The indebtedness to the Wells Fargo Bank & Union Trust Co. was amply secured and could have been discharged, as the executors had in their possession sufficient assets for this purpose, which is likewise true with respect to the indebtedness to Jennie B. Zellerbach, one-half of which, as a matter of fact, was owned by her.

Section 29.162-1(c) of the Regulations provides in part as follows:

> "The income of an estate of a deceased person, as dealt with in the Internal Revenue Code, is therein described as received by the estate during the period of administration or settlement thereof. The period of administration or settlement of the estate is the period required by the executor or administrator to perform the ordinary duties pertaining to administration, in particular the collection of assets and the payment of debts and legacies. It is the time actually required for this purpose, whether longer or shorter than the period specified in the local statute for settlement of estates. If an executor, who is also named as trustee, fails to obtain his discharge as executor, the period of administration continues up to the time the duties of administration are complete and he actually assumes his duties as trustee whether pursuant to an order of court or not."

Under the foregoing provisions of the Regulations, we submit that the Commissioner could have determined that the administration of the estate had been completed for all intents and purposes in 1942, and that the distributable income for said year was in

fact the income of the residuary legatees, even though not paid to them in full. Under such circumstances, the estate would be entitled to a credit for the full amount of the distributable income for 1942 and 1943.

CONCLUSION.

In conclusion, and by way of summary, the taxpayer respectfully submits that the evidence in this case clearly sets forth that the entire income of the estate of the decedent taxpayer, the appellant herein, for the years 1942 and 1943 should be deemed as having been distributed in full to all the residuary legatees of the estate in the proportions which they take under the decedent's will; that the estate is entitled to a credit for all of such income, the same having been included in the respective income tax returns of the residuary legatees for each of said years; that the Tax Court erred in holding said legatees (beneficiaries) had no present right to the 1942 and 1943 income of the appellant; that it further erred in holding that the appellant was not entitled to any deduction for the years 1942 and 1943 under Section 162(c) of the Internal Revenue Code in addition to the amounts actually distributed out of income; that the Tax Court further erred in holding that the provisions of Section 162(d)-(1) of the Internal Revenue Code was not applicable.

Finally, the appellant contends, and respectfully submits, that the decision of the United States Tax Court should be reversed; that the determination that

there were deficiencies in the income taxes for the years 1942 and 1943 in the respective amounts of $1,768.55 and $67,388.46 was erroneous and should be reversed and in lieu thereof it should be determined that the appellant is entitled to a refund for the year 1942 in the amount of $71,585.08 and that there is no income tax due from the appellant for the year 1943.

Dated, San Francisco,
March 15, 1948.

Respectfully submitted,
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